

Letter of Findings: 04-20110009 and 04-20110011
Use Tax
For the Years 2007, 2008, and 2009

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ISSUE

I. Use Tax – Imposition and Exemption.

Authority: IC § 6-2.5-1-2; IC § 6-2.5-2-1; IC § 6-2.5-3-2; IC § 6-2.5-3-4; IC § 6-2.5-4-1; IC § 6-8.1-5-1; IC § 6-8.1-5-4; [45 IAC 2.2-3-8](#); [45 IAC 2.2-3-9](#); [45 IAC 2.2-4-22](#); [45 IAC 2.2-8-12](#); Sales Tax Information Bulletin 60 (July 2006); Lafayette Square Amoco, Inc. v. Indiana Dep't of State Revenue, 867 N.E.2d 289 (Ind. Tax Ct. 2007).

Taxpayer ("Retail Merchant") protests the imposition of use tax on certain of its purchases and on certain of its sales.

STATEMENT OF FACTS

Retail Merchant is an Indiana heating and cooling contractor. The Indiana Department of Revenue ("Department") conducted a sales and use tax investigation of Retail Merchant for the years 2007, 2008, and 2009. According to the Department's auditor, Retail Merchant bills on a time and material basis and performs jobs for exempt entities. The Department requested access to Retail Merchant's records after Retail Merchant was notified of the audit investigation. Retail Merchant did not make records available for examination after numerous requests by the Department.

The Department's audit investigation assessed Retail Merchant additional use tax, penalty and interest for the periods at issue based on the best information available ("BIA") to the Department. Retail Merchant protested the assessment claiming that it mostly did work for exempt entities and also that it had paid sales tax when it acquired tangible personal property used to perform its time and materials contracts. Retail Merchant did not protest the penalty. A hearing was held and this Letter of Findings ensues. Additional information will be provided as necessary.

I. Use Tax – Imposition and Exemption.

DISCUSSION

The Department's audit investigation assessed Retail Merchant use tax on a BIA basis using Biz Stats percentages. The investigation report states:

The starting point for each of the Biz Stat (shown as net profit) is the net income reported by the corporation to the Indiana Department of Revenue. Biz Stat percentages were then used to calculate all categories on the work paper on page eight. To allow the merchant additional labor in the Biz Stats Cost of Goods Sold, auditor divided the Cost of Goods Sold by 1.5 to estimate the materials. The difference between the assessed materials and the Biz Stat Cost of Goods Sold is the additional labor allowance estimated. Although the merchant indicated he was billing time and material, auditor believed use tax on materials would be the most consistent method to make an assessment.

This audit investigation is being prepared and assessed according to [45 IAC 2.2-3-9](#). This Indiana Administrative Code says in part: "A contractor has the burden of proof to establish exempt sale or use when construction material, which was acquired tax-free, is not subject to either the state gross retail or use tax upon disposition."

Retail Merchant protests the imposition of use tax on certain of its transactions arguing that it either paid sales tax when it acquired the tangible personal property or it was used in the performance of time and materials contracts for exempt entities. Retail Merchant finally offered to provide the requisite records in support of its protest at the hearing.

As a threshold issue, although a statute that imposes a tax is strictly construed against the State, all tax assessments are prima facie evidence that the Department's claim for the unpaid tax is valid and the taxpayer bears the burden of proving that any assessment is incorrect. IC § 6-8.1-5-1(c); Lafayette Square Amoco, Inc. v. Indiana Dep't of State Revenue, 867 N.E.2d 289, 292 (Ind. Tax Ct. 2007).

Under IC § 6-8.1-5-1(b):

If the department reasonably believes that a person has not reported the proper amount of tax due, the department shall make a proposed assessment of the amount of the unpaid tax on the basis of the best information available to the department. The amount of the assessment is considered a tax payment not made by the due date and is subject to [IC 6-8.1-10](#) concerning the imposition of penalties and interest. The department shall send the person a notice of the proposed assessment through the United States mail.

IC § 6-8.1-5-4(a) provides:

Every person subject to a listed tax must keep books and records so that the department can determine the amount, if any, of the person's liability for that tax by reviewing those books and records. The records referred to in this subsection include all source documents necessary to determine the tax, including invoices, register tapes, receipts, and canceled checks.

Accordingly, it is Retail Merchant's responsibility to retain the documentation that supports the amounts it used to determine tax owed. Based upon the unavailability of documentation, the Department made an assessment based on the best information available. See IC § 6-8.1-5-1.

In accordance with IC § 6-2.5-2-1(a), a sales tax, known as state gross retail tax, is imposed on Indiana retail transactions unless a valid exemption is applicable. IC § 6-2.5-2-1(b) states:

The person who acquires property in a retail transaction is liable for the tax on the transaction and, except as otherwise provided in this chapter, shall pay the tax to the retail merchant as a separate added amount to the consideration in the transaction. The retail merchant shall collect the tax as agent for the state.

A complementary excise tax, known as the use tax, is imposed on the storage, use, or consumption of tangible personal property in Indiana if the property was acquired in a retail transaction. IC § 6-2.5-3-2. An exemption from the use tax is granted for transactions when sales tax was paid at the time of purchase pursuant to IC § 6-2.5-3-4.

IC § 6-2.5-1-2 defines a retail transaction as "a transaction of a retail merchant that constitutes selling at retail as described in IC § 6-2.5-4-1... or that is described in any other section of IC § 6-2.5-4." IC § 6-2.5-4-1(a) provides that "[a] person is a retail merchant making a retail transaction when he engages in selling at retail." IC § 6-2.5-4-1(b) further explains that a person sells at retail when he "(1) acquires tangible personal property for the purpose of resale; and (2) transfers that property to another person for consideration."

As explained in Sales Tax Information Bulletin 60 (July 2006) (20060823 Ind. Reg. 045060287NRA). "If a construction contractor purchases construction materials pursuant to a time and material contract, the construction contractor is a retail merchant and may purchase the construction material exempt from sales tax but must collect sales tax on the resale of the construction material and remit the sales tax."

The Department refers to [45 IAC 2.2-3-8\(b\)](#), which states that:

All construction material purchased by a contractor is taxable either at the time of purchase, or if purchased exempt (or otherwise acquired exempt) upon disposition unless the ultimate recipient could have purchased it exempt.

The responsibility for the payment of sales and use tax in situations where a contractor is installing tangible personal property on real estate owned by another is set out at [45 IAC 2.2-4-22\(d\)](#) as follows:

A contractor-retail merchant has the responsibility to collect the state gross retail tax and to remit such tax to the Department of Revenue whenever he disposes of any construction material in the following manner:

- (1) Time and material contract. He converts the construction material into realty on land he does not own and states separately the cost for the construction materials and the cost for the labor and other charges (only the gross proceeds from the sale of the construction material are subject to tax);

Pursuant to this regulation, the contractor must collect sales tax and remit that sales tax to the state. If sales tax is not remitted, then under [45 IAC 2.2-3-9\(e\)](#) "[w]ith respect to construction material a contractor acquired tax-free, the contractor is liable for the use tax and must remit such tax (measured on the purchase price) to the Department of Revenue when he disposes of such property in the following manner... He converts the construction material into realty on land he does not own pursuant to a contract that includes all elements of cost in the total contract price."

During the audit investigation, Retail Merchant did not provide the requisite records, including neither purchase invoices showing that it paid sales tax when it acquired tangible personal property later used in the performance of its contracts nor exemption certificates showing it performed work for exempt entities. The auditor was therefore unable to verify the taxability of Retail Merchant's purchases and sales.

The relevant regulation is [45 IAC 2.2-8-12\(b\)](#) which states, "Retail merchants are required to collect sales and use tax on each sale which constitutes a retail transaction unless the merchant can establish that the item purchased will be used for an exempt purpose."

The regulation cautions that, "Unless the seller receives a properly completed exemption certificate the merchant must prove that sales tax was collected and remitted to the state or that the purchaser actually used the item for an exempt purpose. It is, therefore, very important to the seller to obtain an exemption certificate in order to avoid the necessity for such proof." [45 IAC 2.2-8-12\(d\)](#). Therefore, if the purchaser claims an exemption, the exemption certificate should be obtained at the time the transaction occurs otherwise the burden on Retail Merchant of proving the transaction was exempt becomes measurably more difficult. Retail Merchant will have to request that its purportedly exempt customers fill out an AD-70 form, which is the form used to allow exemption after the transaction has occurred.

There is no question that Retail Merchant entered into retail transactions for which – absent an exemption – Retail Merchant was required to pay sales tax or remit use tax.

Retail Merchant has, somewhat belatedly, supplied requisite documentation. Retail Merchant has provided some exemption certificates along with some filled out AD-70 forms. Retail Merchant has also provided sales

invoices with summaries and purchase invoices with summaries.

The Department is prepared to accept the exemption certificates Retail Merchant has presented, on condition that if the exemption certificate is dated after the particular transaction(s) occurred, that exemption certificate must be accompanied by a properly completed AD-70.

As for the sales and purchase invoices, the Department is prepared to accept those invoices that show sales tax was paid.

Retail Merchant is sustained subject to the results of a supplemental audit consistent with the above.

FINDING

Retail Merchant's protest is sustained subject to the results of a supplemental audit.

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